THE BANKING SYSTEM OF MEXICO[1]

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THE functions of discount, deposit and issue are exercised in the Republic of Mexico by twenty-four banks, all governed by a uniform law, first passed in 1897, but later amended, as need arose, especially in 1908. Nine of these banks had been established prior to 1897, and two of them in particular had at that time such special privileges for settled terms, that they were given an exceptional position under the new law.

The older of these was the Bank of London and Mexico, established at the City of Mexico in 1864, and at first without special charter. Nothwithstanding the opposition of the commercial houses, who had theretofore carried on a variety of banking and credit activities as incidents of their business, especially of the import and export trades, this bank had grown pretty steadily in strength and had gained good credit, not only for its obligations generally, but also for its issues of notes.

In 1875, two or three small banks, also banks of issue, were founded under state authority in Chihuahua, and in 1879 the century-old *mont de piêté* or loan office got the right to do a banking business and issue certificates of deposit payable on demand. These, however, were issued for odd rather than for even sums and were not suited to serve exactly like bank notes for a circulating medium.

Congress in 1881 gave the company afterwards known as the International Bank of Paris a charter for a bank of issue with a capital stock of $8,000,000 (eight million pesos). This bank entered the field under the style of the National Bank of Mexico; to it were given the functions and opportunities of cashier of the national treasury. It was required to keep its circulation

[1] Abridged from *The Banking System of Mexico*, by Charles A. Conant, Washington, 1910. National Monetary Commission. (Senate doc. 493, 61st Cong., 2d sess.)

covered by readily negotiable securities and to keep a cash reserve equal to one-third of its outstanding notes. The Mexican Mercantile Bank, shortly afterwards started without charter, was absorbed by the National in 1884.

The same year (1884), general rules for the incorporation of banks were laid down in the code of commerce. In recognizing existing charters Congress reserved to the federal government as against the governments of the several states the exclusive right to grant new charters. Issue without government concession was forbidden, the limit of circulation was fixed at thrice the metallic reserve, permission was given to secure one-third the circulation by a deposit of money or government securities, and the circulation was taxed at 5 % on the amount outstanding. The quality of a bank's assets—or the character—was not prescribed. Under this law, several new banks were founded, but the measure lost its importance in consequence of the new charter given shortly afterward to the National Bank of Mexico. In this instrument, the monopoly of banking in the Federal District (surrounding the City of Mexico) seems to have been confirmed to the National Bank and the Bank of London and Mexico. To the National Bank, more particularly, were given certain guarantees against the creation by the government of any further banks. The National Bank was allowed a commission of 2 % for the collection and disbursement of government funds, and 2 % for the service of the national debt, while on its side, the bank undertook to grant the government a standing credit of $2,000,000 free of interest.

By the year 1896 the treasury had succeeded in adjusting the financial difficulties that the country had suffered as one domestic phase of the world-wide disturbances of 1892–1894. Balance had been restored to the budget; the public debt had been put in order; freedom of internal commerce had been achieved through the abolition of tolls upon interstate traffic. Meanwhile, either through concessions from the federal government itself (there being two views as to the scope of the pledges given the National Bank) or under charters from one or another of the states, the number of banks had been increased. But of the nine then in existence, the two domiciled

at the capital had capital stocks of $30,000,000 out of a total for all banks of $35,550,000, and note issues of $33,366,145 out of a total of $38,497,467. There was much diversity in powers and duties of these banks. Furthermore, the general rules touching banks in the code of commerce of 1884 had been omitted in the revision of 1889. Properly to help any possible commercial, agricultural and industrial expansion by a well-ordered development of credit institutions it seemed needful now to adopt well-considered and uniform banking laws.

Toward this end, the minister of finance, Señor Jose Y Limantour, prepared in 1896 for a general law upon the incorporation, establishment and operation of banks of issue, mortgage banks and banks of other kinds, and modified the concession to existing banks to make them conform so far as might be to the general law. The " General Law on Institutions of Credit," the preparation of which was intrusted to a commission of bankers (the heads of the three largest banks) and lawyers expert in economics and finance, went into force March 19, 1897. In its final form, this law dealt only with banks of issue, mortgage banks and credit banks (or banks of promotion). The proposals relating to loan pledge banks, savings banks and storage and warehouse institutions which had been advanced by the commission were reserved for later consideration.

In deciding upon what principles the new law should be based, the commission and the minister cast aside at the outset the notion that the right of issue should be confined to a single bank. The constitution of the republic was against it, even though a qualified monopoly had been given the National Bank by charter; public opinion opposed the policy; vested interests arising from later grants would be injured; and political considerations forbade. Close connection between the grantor and beneficiary of a monopoly seemed inevitable. Disaster might come too easily from such a relation between a bank and a government necessarily exposed to chance and change. From the practical view, further, it was argued that successful monopolies of issue were mostly to be found in small countries of dense and homogeneous population, without great variety of climate or resources, or in absolute monarchies. To such as

these, the republic of Mexico, in point of varied products, sparse population, imperfect means of communication and vast expanse of territory, presented the sharpest contrast possible. Local needs, it was believed, were best served by local banks with knowledge of such needs gained on the ground, the initiative and authority of branch banks being less than those of local concerns and their policy being less flexible by reasons of administrative necessity. Finally, to encourage a number of banks to enter business was likely to pave the way for a specialization, in the course of which the great banks of the Federal District would become banks of rediscount and the local banks the original source of local loans, the two classes thus serving as complementary members of a well-balanced system.

Perfect freedom of banking, on the other hand, was reckoned no less unsuitable and undesirable than perfect monopoly. Even the plan to permit anyone who met stipulated conditions to begin banking without a special concession, something after the fashion of national banks in the United States, was rejected. As the minister pointed out in a special report of 1897, the familiarity of the citizens of the two countries with the practise of individual liberty, the culture of the masses and their experience in business matters were by no means identical. Banks had been established but lately in Mexico, the country's practise in the use of credit was but scant, and outside the greater centers the distrust of credit instruments was great, while a certain spirit of imitation was likely, if freedom of banking were conceded, to lead to an undue multiplication of banks. Once a failure occurred, even a small one, a violent reaction against bank-note issues might follow. The government decided accordingly not to go as far as they could, believing it better to be able later on to widen the scope of the legislation than to be forced to narrow it.

With this in mind, a species of banking oligarchy was created. Under the policy adopted, authorization to establish institutions of credit was to be granted only upon special application. And after the first bank had been founded in each of the states, either through one of the banks already in existence accepting

the terms of the new law, or through a new establishment obtaining a charter, subsequent foundations were to be permitted only on terms so onerous as to be practically prohibitive.

While the new law was preparing, negotiations with the banks already chartered proceeded. The National Bank of Mexico waived any rights its charter might have given it in relation to the authorization of other banks, and agreed to raise the non-interest-bearing credit of the Treasury from $2,000,000 to $4,000,000, to reduce its commission on the collection and disbursement of government funds from 2 to 1¾ %, while accepting the risks of this work, and to reduce its commission on the service of the consolidated debt from 2 to 1 %. Further, it agreed to open for the *mont de piêté* a standing credit of $500,000 at 3 %. On the other side, the National Bank had fifteen years added to the term of its charter and obtained a stipulation that for ten years the National Loan Office should not exercise its dormant authority to issue certificates of deposit or notes payable at sight to bearer. The Bank of London and Mexico, the only other bank which shared with the National Bank the right to keep offices and to issue notes in the Federal District as well as other parts of the country, obtained, on its undertaking to submit to the general law, that extension of its charter which was essential to attract subscription to a considerable increase of its stock.

The mortgage banks permitted by the law of 1897 were of the sort well known in Europe, which issue bonds for long terms and even sums against the general security of realty pledged to them by their borrowers. In no case, under the Mexican law, were such banks permitted to lend except on first lien or to more than half the value of the property pledged, as determined by expert appraisal. Neither might the banks lend on mines, forests, fixtures, churches or buildings for federal, state or municipal purposes. The total of bonds outstanding, the issue of one bank, was limited to twenty times the capital of that bank, as well as to the amount of loans on mortgage, made by it, and each bank was required to maintain a special cash guarantee fund in amount larger than a half-yearly service of interest on the bonds outstanding. Holders of the bonds

enjoyed a prior lien against the mortgages, fund and capital paid up or uncalled.

The banks of promotion—credit banks or finance banks—were intended for the provision of credit to agricultural, mining and industrial ventures for longer terms and on different security than it seemed proper for commercial banks of issue to accept. These also were authorized to issue a sort of bond, but the term of such bonds was limited at first to two and later (in 1908) to three years. Proceeds of these bonds might be lent on mortgage, but not up to more than fifteen per cent of the value of the property benefited. Lending to mining ventures was conditioned on the report of experts that the proceeds would suffice for repayment, and the banks were given the right not only closely to supervise the management but also to have the proceeds remitted to them as they were realized. Banks of promotion might also guarantee notes running not more than six months, or lend upon the collateral security of stocks and bonds. Forty per cent of their deposits on demand or on three days' notice they were required to hold in cash—the remainder in paper discounted for not more than six months.

Like the mortgage banks and banks of promotion, the banks of issue authorized by the new law were to be limited-liability joint-stock concerns, the liability of the shareholders being limited to the amount of stock for which they had subscribed. No bank of issue could be started without special concession of the Executive of the Republic, and no concession was to be granted unless government bonds nominally worth twenty per cent of the minimal required capital had been deposited in the national treasury or the National Bank of Mexico. Directly the bank started, this deposit was to be returned. The companies to which operation of banks of issue was confined were to consist of at least seven members; their capital stock was to be not less than $500,000 (raised in 1908 to $1,000,000) of fully-subscribed capital of which not less than half was to be paid up, and it was required that until that fund was equal to a third of the capital, ten per cent of the profits should be set aside each year to the reserve fund. Charters were limited to thirty years from the date of the law for banks of issue. For-

eign banks were forbidden to open agencies in the republic for the issue or redemption of notes.

In respect more particularly of issue, the monopoly for that field of the two banks domiciled in the Federal District was continued. Elsewhere banks could be established, but solely according to the terms of the law of 1897. The total amount of notes of any bank outstanding was limited to thrice the paid-up capital; the sum of notes outstanding and deposits payable on demand or at not more than three days' notice to twice the bank's holdings of cash and gold and silver bullion. The apparent severity of this latter restriction was tempered by the exclusion from the category of demand deposits of deposits on "account current" (in reality the proceeds of loans, and in practise the item in which is reported a great part of the Mexican banks' lending business) and accounts at reciprocal or differential interest, even though these were subject to check. The bank whose circulation ran in excess of either of the limits fixed was required so to report to the minister of finance and to abstain from making new loans. Fifteen days later if the circulation were still in excess, the finance department might give the bank not more than a month in which to adjust its circulation on pain of liquidation and charter forfeiture.

Bank notes could be issued only in denominations of $5, $10, $20, $50, $100, $500 and $1000 as non-interest-bearing, non-legal-tender promises to pay to bearer on demand dated at the place of issue and signed by officers of the bank and government inspectors. They gave the holders a lien on the bank's assets prior to all other creditors of the issuer save owners of property pledged to the bank, mortgage creditors when the mortgage involved had been registered previous to the transaction whereby the bank acquired the mortgaged property, and the federal, state and municipal governments. The notes were valid obligations against the promisor during the whole term of its existence. Even as against a failed or liquidated bank they were to lapse only five years after the failure or liquidation. Head offices, apparently, were required to redeem on presentation both their own notes and those of the branches; branches, only such notes as they had put into circulation. Under the

amendment of 1908, banks of issue were required periodically to exchange the notes of other banks in their possession and in the absence of express agreement to the contrary, to settle balances in cash. Further, to guard against overissue, it was forbidden to put notes into circulation unless the proper stamp had been engraved upon them by the government stamp-printing department. To this the finance department could give permission only when satisfied that the limit of issue would not be exceeded.

According to article 29 of the amended law, it is prohibited to banks of issue:

1. To make loans or discount notes or other paper running for more than six months.

2. To discount notes or other commercial paper without at least two signatures of well-known solvency, unless collateral is given.

3. To make loans secured by mortgage except in the cases set forth in the following article.

4. To make loans without sufficient collateral to persons or associations not domiciled or having business of importance in the states or territories wherein the home office, branches, or agencies expressly authorized by the treasury department may be located. From this provision are excepted operations between banks.

5. To mortgage their real property or borrow on their credits.

6. To pledge or pawn their bank notes or to contract obligations respecting them.

7. To accept uncovered bills of exchange or drafts, or to open credits not revocable at discretion by the bank.

8. To hold corporation stocks or bonds exceeding 10 % of the amount of paid-up capital and reserve at the time. Securities representing the federal debt and others where the capital or revenues are guaranteed by the government are not included in this limitation.

9. To operate on their own account mines, metallurgical offices, mercantile establishments, industrial or agricultural enterprises, or to take part, either by general or silent partnership, in associations [except under certain specified circumstances].

10. To engage in insurance operations.

11. To accept responsibilities, whether direct, indirect, or associate, from any single person or association, which in the aggregate exceed 10 % of the paid-up capital of the establishment. Rediscounts between banks are excepted.

There remain now to be noted, among the clauses of the law applicable to all banks, a number of restrictions likely to make for the sound conduct of banks of issue. Banks of all sorts were forbidden, for one thing, to acquire real estate except what might be needed for office purposes or what they might take over in settlement of claims. Property of the latter sort banks of issue were enjoined to sell within two years, otherwise the department of finance was in duty bound to sell it for them. Banks were forbidden to buy their own shares or to do business on the security of such shares. Neither might they consolidate with other banks without the permission of the department of finance. Sanction for the more important inhibitions of the law was provided in the shape of forfeiture of charter, on the one hand, and on the other, in the civil and criminal liability of boards of directors and of managers. During the first year of a bank's existence, the members of the board of administration were forbidden to become debtors of their bank, either directly or through companies in which they were interested. After that time, they might borrow only when another firm of well-known solvency was associated in the debt or when adequate collateral security was furnished. Before they acted, however, as members of the board, they were required to give bond in the form either of a cash deposit or of shares of the bank as the by-laws might prescribe. Managers and officers might not on any account transact private business with the bank, obligate their firms thereto or become sureties.

Quite apart from these internal precautions, or better perhaps independently of them, the law established a system of thorough-going external inspection of its creatures and arranged for its exercise by the department of finance either through inspectors permanently appointed for each bank, or through special inspectors appointed for particular cases. Their duties were carefully laid down in the law.

Fairly full monthly reports of assets and liabilities, though by no means so detailed as the Canadian banks are obliged to make, were required of all institutions of credit. On the whole, the form of report selected was probably adequate to any necessary publicity.

In putting the new system of regulation into effect, it was provided that all the existing banks in the several states, if they chose to accept the terms of the law, should be considered "first" banks of issue in the states where they were domiciled, whatever their number. By becoming "first" banks, they obtained a relaxation or reduction of divers stamp duties, a reduction of notarial fees and, except for the tax on lands and buildings occupied for office purposes, an exemption from federal, state and municipal taxation.

In states or territories where no bank was domiciled at the time the law was passed, the first corporation thereafter to be organized became the "first" bank. And to these "first" banks was insured a practical monopoly until 1922, in their respective territories, save for the competition offered by branches of the two great banks of the Federal District. The law provided, that is, that to none other than the first banks should there be granted either reduction of stamp duties or exemption from taxation. It went further in fact and laid down the rule that other than "first" banks should be subject not only to all taxes imposed by general laws, but also to a special federal tax of 2 % per annum on their several paid-up capitals. The position of the favored few was reinforced by a law of 1905, which forbade the issue of additional concessions (charters) until after December 31, 1909. The law of 1908 extended this term until March 19, 1922.

Under the law of 1897, as amended now and again, and as interpreted from time to time in circulars issued by the department of finance, there were working on June 30, 1909, twenty-four banks of issue, with an authorized capital of $118,800,000 (of which all but a million odd was paid); two mortgage banks, with a capital of $10,000,000 ($8,500,000 paid up), and six banks of promotion, with $47,800,000 capital authorized and $44,800,000 paid in.

The two mortgage banks had served perhaps as well as possible the purposes for which they had been authorized. At any rate, they had outstanding on June 30, 1909, the tidy sum of thirty-seven millions of mortgage loans and total assets of nearly fifty-two millions.

So far as it dealt with banks of promotion—credit or finance banks—institutions for the encouragement of agricultural, mining and industrial enterprises, the law seems to have imposed restrictions so severe as to hinder seriously and almost to defeat its objects. Chief of these banks was the *Banco Central Mexicano*, with $30,000,000 paid-up stock, a venture started in the Federal District, largely with the aid of foreign funds, as a bank of rediscount for the state banks and as an agency of redemption for their notes, but only as presented by other banks. With the growth of function of this institution, it has become a bank of banks, a clearing agent, a representative of provincial finance at the capital, and the organ through which mutual support is extended jointly to their several colleagues by the banks of issue in the states. As it is now and has been since 1902, each such state bank holds shares of the *Banco Central* equal to 10 % at least of the holder's capital. It carries with the *Banco Central* an account at differential interest, with the right to a credit equal to its share in the Central's capital. And directly it considers itself threatened, it may call on the *Banco Central* for the use of a fund—equal to 50 % of the capital of the bank in trouble—which is contributed by the other banks in amounts not to exceed 2 % of their several capitals. The money thus obtained is used to redeem the notes of the threatened bank, but at a charge to the beneficiary of 12 % and the costs of the operation. What part of the stock of the *Banco Central* the state banks did not furnish has been taken by foreign syndicates, without, however, their gaining thereby the right to interfere in the Mexican management of the bank. The assets of this corporation amounted on June 30, 1909, to $89,011,861, of which discounts stood for $13,649,884, loans on collateral for $22,476,887, creditor accounts current (loans) for $11,279,234, and accounts in trust (for the most part funds in transfer or awaiting collection) for $14,398,570. In 1908 its cash turnover was more than two and a half billions.

Additions to the number of banks of issue proper began under the law of 1897 soon after Congress passed it. Over the whole period—say roughly from January 1897 to June 1909—there has been an increase in the paid-up capital of banks of

issue from $23,010,000 to $111,780,700; in their coin and bullion from $42,573,025 to $84,352,541. Other items of the balance sheet compared as of slightly different dates show:

	December 31, 1898	June 30, 1909
Stocks and bonds	694,436	41,152,212
Discounts	56,588,275	87,058,205
Loans on collateral	22,440,691	53,219,342
Mortgage loans	418,268	10,432,603
Various credits	36,380,843	446,772,325
Total assets	170,650,776	736,191,398
Capital paid up	29,295,000	117,780,700
Reserve fund	3,757,864	32,584,425
Special guaranty fund	3,212,379	18,723,668
Deposits at sight or at not more than 3 days	1,143,623	72,126,285
Deposits at more than 3 days	2,199,886	56,125,969
Notes in circulation	54,375,769	92,221,477
Various debits	61,961,253	343,609,572
Total liabilities	170,650,776	736,191,398

The figures of the right-hand column are some distance below the high mark for the items of discounts, loans and various credits, in which, of course, the creditor accounts current appear. Reserve funds and notes in circulation reached their high point in June, 1907, prior to the panic or contraction from which Mexico suffered that year in common with the United States. It is not without significance that the reduction in reserve funds alone amounts to nearly $12,000,000. In an abridgment so brief as the present it is impossible even superficially to follow Mr. Conant's scholarly and luminous account of the economic sequences of the industrial progress of Mexico during the last fifteen years, of the influx of foreign capital, the effect of the fall and the subsequent rise in the value of one of the country's chief products—silver bullion, the manner in which Mexican currency was shifted to a gold standard, the methods, purpose and influence of the supervision exercised by the government over banks of all sorts, and the conduct and experience of the banks in the crisis and liquidation of 1907. But attention ought to be called to certain outstanding facts.

One is, that in spite of increased competition in the function

of issue, the great central bank, with its place of vantage as financial agent of the government, has more than held its own. The paid-up capital of the National Bank of Mexico on June 30, 1909, was more than $31,500,000, out of a total of $117,780,700; its reserve fund $16,000,000 out of $32,584,425; its circulation $40,214,874 out of $92,221,477; and its total assets $300,455,221 out of $736,191,391 for the whole system. Next was its still older colleague in the Federal District, the Bank of London and Mexico, with $32,250,000 in capital and reserve, $14,175,096 of circulation and total assets of $180,143,356. Two such powerful banks as these must alone be mighty factors for conservatism and soundness in a system containing no real rivals. It ought to be remarked, too, that the small number of banks, and the extraordinarily wide powers of visitation—more the powers of censors than of mere inspectors—conferred upon the officers of the ministry of finance were well calculated to check banking indiscretions, errors and excesses against which the safeguards of the statutes alone might not have sufficed.

So far as the public is concerned, the banks appear to have supplied a service which in large measure, at all events, has been satisfactory. A considerable reduction of the rate of interest has been brought about, and with the increase of banking offices, a wider and better distribution of credit. In exercising their rights of issue the banks have furnished paper currency in quantities quite adequate to a population long used to hard money and inclined to prefer it. The ultimate security of this paper has been protected by the preferred lien given its holders against the assets of the issuers; freedom from depreciation by the immediate convertibility practically assured by the reserve requirements, by redemption at the head offices of the state banks and by the note redemption exercised on their behalf in the Federal District by the *Banco Central.*

The demand for long-term credit in the expansion which preceded the troubles of 1907 was so powerful and insistent that banks of issue were tempted to enter the field which the banks of promotion were intended to work. More than one of the banks of issue yielded to the temptation; indeed, the pressure was more or less effective upon most of them. Some part of

their own funds and the funds entrusted to them became tied up and unavailable. Certain risks that they assumed, notably loans upon the bonds and stocks of irrigation and agricultural development ventures, could not be turned promptly into cash. The federal government stepped in and assumed authority in the act of June 17, 1908, to invest a sum of not more than $25,000,000 in works for the utilization of water for agriculture and stock-raising, either by executing them directly or through assistance to private enterprises. At this time, further, the executive was authorized to guarantee both principal and interest of bonds issued by specially chartered institutions lending for long terms at moderate interest to agricultural, cattle-raising, combustible mineral and metallurgical enterprises. Four of the largest banks furnished a third of the funds toward a new mortgage-loan company capitalized at $10,000,000 and authorized to issue bonds as a first lien against its assets; the government another third, and public subscription the remainder. Within less than eight weeks from the date of the concession, this new land bank floated $20,000,000 of its bonds, guaranteed in full by the republic and free of tax, upon the markets of New York and Europe. Thus long-term securities were exchanged for liquid foreign capital, the character of the assets of Mexican banks notably improved, and the banks' position vastly eased.